CO-OPERATIVE CENTRAL BANK BHD.

v.

SYKT. BUKIT TINGGI & ORS.

HIGH COURT MALAYA, PENANG
MOHAMED DZAIDDIN J
[ORIGINATING SUMMONS NO. 24-396-1985]
29 OCTOBER 1990

COMPANY LAW: *Whether provisions of Companies Act applies to cooperative societies - Whether loan or security or guarantee avoided - Knowledge of breach of directors duties - Void - Companies Act 1965, s. 133(5), Co-operative Societies Act 1948, s. 57.*

STATUTORY INTERPRETATION: *Plaintiff cooperative society - Whether Companies Act applicable to it - Cooperative Societies Act 1948, s. 57, Companies Act 1965, s. 133(5).*

LAND LAW: *Charge - Conflicting provision in sale and purchase agreement as to whether vendor can create incumbrance on the property - Whether rights of chargees affected - National Land Code 1965, s. 340.*

On 14 June 1990, the Court granted the plaintiff's, CCB (in receivership) application for sale of the charged properties which belonged to the 1st defendant D1; however orders under s. 257(1) of the National Land Code (NLC) were not made. D1 executed a third party charge on 25 January 1984 in favour of UMBC as security for a loan of RM600,000 given to C, a director of D1. CCB is a cooperative society registered under s. 7 of the Cooperative Societies Act 1948. The defendants applied for further argument, among the new issues raised were:

1. The failure to consider the effect of s. 34(b) of the sale and purchase agreement that prior approval of the purchasers is required before the premises is subject to any encumbrances - whether there is a conflict with s. 31 which empowers the vendor to charge the said land prior to registration of the transfer documents.

2. Whether the charge created by D1 was valid as there was a contravention of s. 133 of the Companies Act 1965 (the Act) - per N.H. Chan J in *Che Wan Development v. CCB* [1990] 1 CLJ (Rep) 702.

Held:

[1] It is quite obvious that s. 34(b) would prevail over the proviso of s. 31 because the former section clearly provides that immediately after the execution of the agreement, the vendor must first obtain the approval of the purchasers before subjecting the premises to any encumbrances i.e. the charge; s. 31 would only operate once an issue document of title was issued.

[2] (a) Under s. 4 of the recitals of the said agreement, it is clearly stated that the said land was presently charged by the vendor to UMBC with the knowledge and approval of the purchasers.

(b) Therefore, whilst the defendants may have a cause of action for breach of contract against D1 under the respective sale and purchase agreements, the rights of UMBC as chargee remain indefeasible under s. 340(1) National Land Code unless the defendants could prove fraud or misrepresentation or any other grounds provided under subs (2) of s. 340.

[3] (a) *Che Wan's* case is distinguishable from the present case as in that case, CCB granted a loan of RM20 mil to its member, who was CCB's director, secured by a charge on CCB's lands. However, on the facts it would appear that *Che Wan's* case does not help the 2nd to 19th defendants at all because s. 133 of the Act cannot apply to them. As the purpose of the section is to protect company funds and the interest of shareholders and creditors, only persons under the said categories could ask for a declaration as in *Che Wan*. Unfortunately, none of the defendants are shareholders or creditors of D1.

(b) The decision of N.H. Chan J in *Che Wan* is to be treated as *per incuriam* because:

(i) It was made without the Judge's attention being drawn to s. 57 of the Cooperative Societies Act. It follows that the provisions of the laws in force relating to companies i.e. the Companies Act 1965 do not apply; Therefore, s. 133 of the Companies Act does not apply to the plaintiff.

(ii) The effect of s. 133(5) was not argued nor was it brought to the attention of the learned Judge; how could the company be liable under the guarantee or security unless they were valid and enforceable against it? Where the third party i.e. the borrower knew or ought to have known of the breach, it may be that the security or guarantee is voidable at the company's instance. Sections 65 and 66 of the Contracts Act 1950 makes no distinction with respect to the consequences of a voidable and void agreements.

[4] The 2nd to the 19th defendants have failed in their application to declare the charge void and unenforceable. In the result, they have failed to show the existence of cause to the contrary under s. 256(3) National Land Code.

[Order for sale granted.]

Case referred to:
Che Wan Development Sdn. Bhd. v. Co-operative Central Bank Bhd. [1990] 1 CLJ (Rep) 702

Legislation referred to:
Companies Act 1965, ss. 133, 67
Contracts Act 1950, ss. 65, 66
Co-operative Societies Act 1948, ss. 7, 30, 57
National Land Code 1965, ss. 256(3), 257(1), 340(1), (2)
Rules of the High Court 1980, O. 56 r. 2

For the Plaintiffs - Vijay Kumar Natarajan; M/s. Kumar Jaspal & Quah
For the 1st Defendant - S.P. Annamalai; M/s. Annamalai & Co.
For the 2nd & 3rd Defendants - R.J. Manecksha; M/s. Ong & Manecksha
For the 4th to 19 Defendants - Lee Kok Liang; M/s. Lee Kok Khiang & Co.

[**Editor's Note:** The 2nd to 19th defendants are appealing to the Supreme Court.]

JUDGMENT

Mohamed Dzaiddin J:

On 14 June 1990 I granted plaintiffs' application for an order for sale of the charged properties belonging to the 1st defendant, but postponed making further orders under s. 257(1) National Land Code. In the meantime, on 21 August 1990, on an application made on behalf of the defendants under O. 56 r. 2 Rules of the High Court 1980, I heard further argument on the matter.

I shall now deal with some of the new issues raised by Counsel. First, Encik Lee Kok Liang, for defendants No. 4 to 19 pointed out that I failed to consider the effect of para. (b) of s. 34 of the sale and purchase agreement. This paragraph states:

Immediately after this agreement shall have been executed by the parties hereto, the vendor will not subject the premises to any encumbrances without prior approval of the purchasers.

Counsel submitted that it is clear from the above section that prior approval of the purchasers is required before the premises is subject to any encumbrances. No such approval or consent was given by the purchasers (defendants). In response to the argument, Encik Kumar submitted that s. 31 is quite explicit as the proviso gives the vendor the right to charge the said land and/or the premises. Thus, by signing the sale and purchase agreements, the purchasers clearly consented to the charge being created in favour of the United Malayan Banking Corporation. The proviso of s. 31 of the agreement reads as follows:

Provided that prior to the transfer herein mentioned the vendor shall have the right to charge or mortgage the said land and/or the premises to a financier on such conditions as the vendor and the financier may in their absolute discretion agree upon.

Looking at both sections, there appears to me to be a conflict with regard to the right of the 1st defendant as vendor to subject the premises to any encumbrances. The charge on the property is an encumbrance. Thus whilst the proviso of s. 31 of the sale agreement empowers the vendor at any time before the registration of the transfer of the premises upon the issuance of issue document of title in favour of the plaintiff to charge the said land and/or the premises to any financier, s. 34(b), on the other hand, prohibits the vendor immediately after the execution of the sale agreement to create any encumbrances on the premises without prior approval of the purchasers. Based on the affidavits of the purchasers, it is clear that no such approval was given by them. In my view, in construing the two sections it is quite obvious that s. 34(b) would prevail over the proviso of s. 31 because the said section clearly provides that immediately after the execution of the agreement, the vendor must first obtain the approval of the purchasers before subjecting the premises to any encumbrances i.e. the charge. On the other hand, s. 31 would only operate once an issue document of title was issued. In the circumstance and on a proper construction of the sale and purchase agreement, the vendor must first obtain approval of the purchasers before charging the premises to a third party. However, in the present case the rights of United Malayan Banking Corporation as chargee of the said land are not affected by the provisions of the sale and purchase agreement because at the time of the execution of the said agreement by the 2nd defendant and others the said land was already charged to United Malayan Banking Corporation. Under s. 4 of the recitals of the said agreement, it is clearly stated that the said land was presently charged by the vendor to United Malayan Banking Corporation with the knowledge and approval of the purchasers. Therefore, whilst the 2nd defendant and others may have a cause of action for breach of contract against the 1st defendant under the respective sale and purchase agreements the rights of United Malayan Banking Corporation as chargee remain indefeasible under s. 340(1) National Land Code unless the 2nd defendant and others could prove fraud or misrepresentation or any other grounds provided under subsection (2) of s. 340. Here, I confirm my earlier finding that the defendants have failed to prove fraud/misrepresentation.

Next, on a further submission of Encik Lee regarding the Housing Developers (Control & Licensing) Rules 1970 and that the Rules prohibit any of the parties to contract out, it is again my finding that the Rules do not affect the rights of the plaintiffs as chargee. I still stand by my earlier finding.

Encik Rumi Manecksha, for the 2nd and 3rd defendants, also raised a new point regarding the validity of the charge created by the 1st defendant in favour of the plaintiff bank. Counsel submitted that the said charge is void and unenforceable because the property of the 1st defendant was used as security for a loan given by the plaintiff to one Chiam Choon Tee, a director of the 1st defendant, thereby contravening s. 133 of the Companies Act 1965. His argument is based entirely on the decision of my learned colleague, Chan J in *Che Wan Development Sdn. Bhd. v. Co-operative Central Bank Bhd.* [1990] 1 CLJ (Rep) 702. Let us now consider if there is merit in this argument. On the facts, in the present case, it is not disputed that the 1st defendant executed a third party charge on 25 January 1984 in favour of the plaintiffs bank as security for a loan of RM600,000 given to Chiam who, we have to assume, was at the material time a director of the 1st Defendant. It is also not disputed that the plaintiffs, now under receivership is a cooperative society registered under s. 7 of the Cooperative Societies Act 1948. However, once again we have to assume that Chiam was a member of the plaintiffs for him to be given the loan as authorised by s. 30(1) of the same Act. Thus far, the facts here are quite similar to *Che Wan* except for one distinguishing factor. There, the defendant (who is the plaintiff in this originating summons) granted a loan of RM20 million to its member, who was also a director of the plaintiff, which was secured by a charge on the plaintiff's lands. The plaintiff's application, which was purely based on law, was for declaration that the third party charge which the plaintiff created in favour of the defendant was void and unenforceable for contravening s. 133 of the Companies Act 1965. The essence of s. 133 is that it prohibits a company from entering into a guarantee or providing any security in connection with a loan made to its directors by any other person. Based purely on law and after considering a series of case laws and the relevant or similar sections of the companies laws in Australia and the United Kingdom, Chan J came to his finding that any transaction which contravened any of the prohibitions in (s. 67 or) s. 133 of the Companies Act 1965 is illegal and therefore void. Be it noted here that the rationale behind the enacting of s. 133 is to protect the company from having its assets depleted through misuse as well as to protect the interest of shareholders and creditors. However, on the facts it would appear to me Che Wan does not help the 2nd to 19th defendants at all because s. 133 cannot apply to them. As the purpose of the section is to protect company funds and the interest of shareholders and creditors, only persons under the said categories could ask for a declaration as in *Che Wan*. Unfortunately, none of them are shareholders or creditors of the 1st defendant.

Secondly, I must, with respect, treat the decision in *Che Wan* as *per incuriam* because it was made without the Judge's attention being drawn to s. 57 of the Cooperative Societies Act. This section states that the provisions of the laws for the time being in force relating to trade unions, associations, societies and companies shall not apply to societies registered under this Act. It follows that for the plaintiffs, a registered society under the Act, the provisions of the laws in force relating to companies i.e. the Companies Act 1965 do not apply. Therefore, s. 133 of the Companies Act does not apply to the plaintiff.

Next, I also find that the effect of s. 133(5) was not argued nor was it brought to the attention of the learned Judge. This subsection provides that nothing in the section will operate to prevent the company from recovering any amount for which it becomes liable under a guarantee or security given contrary to the section. There is a persuasive argument advanced by Walter C.M. Woon, the learned author of *Company Law, Longman* at p. 179 under "Loans to Directors' Companies", who argued that nothing in the section avoided the loan or guarantee or security. It was suggested that where a person who took the company's guarantee or security did not know of the breach of the directors' duties in authorising the

transaction that guarantee or security would be valid and enforceable against the company. According to the learned author, this is implied by subsection (5) of the section and went on to ask how could the company be liable under the guarantee or security unless they were valid and enforceable against it? In my view, this argument makes a lot of sense. Again, where the third party i.e. the borrower knew or ought to have known of the breach, it may be that the security or guarantee is voidable at the company's instance. The argument put forward here is that our Contracts Act 1950 makes no distinction with respect to the consequences of a voidable and void agreements. See ss. 65 and 66.

Therefore, after reappraising the entire case and reviewing some of the authorities and points raised in the further arguments, I have now come to the same conclusion as before, that the 2nd to the 19th defendants have failed in their application to declare the charge void and unenforceable. In the result, it is my finding that they have failed to show the existence of cause to the contrary under s. 256(3) National Land Code. Accordingly, I grant the plaintiffs an order for sale in accordance with s. 257 as follows:

1. Balance due as at today: RM1,898,886.57.
2. Date of auction: 16 May 1991
3. Further directions to apply to the Registrar.
4. Costs of the application and further arguments.

Also found at [1991] 1 CLJ 590